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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 250

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Petition for Writ of Certiorari

To the United States Circuit Court of Appeals for the Ninth Circuit

and

Brief in Support of Petition

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LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Petition for Writ of Certiorari

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, Leland Stanford Junior University and Elmer H. Shine, respectfully pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit (R. 3000-1) entered April 1, 1943, in a case numbered and entitled on its docket No. 10,270, *The National Supply Company, a corporation, Appellant, vs. Leland Stanford Junior University and Elmer H. Shine, Appellees,* reversing a judgment of the United States District Court

for the Northern District of California, Southern Division, in favor of petitioner, Leland Stanford Junior University, and against respondent, The National Supply Company, in the sum of $260,840.38, together with costs of $1,670.66 (R. 313-15). Petition for rehearing was denied by the Circuit Court of Appeals on May 22, 1943 (R. 3001).

SUMMARY STATEMENT OF THE MATTER INVOLVED

Petitioner Shine is a mere nominee and petitioner Leland Stanford Junior University, herein called "Stanford" or "plaintiff", will be treated as sole plaintiff. Stanford sued respondent, The National Supply Company, a Pennsylvania corporation, herein called "defendant", because of defendant's responsibility for the liabilities of its predecessors in a statutory consolidation. These predecessors were The National Supply Company of Delaware, herein called the "Delaware corporation", and its subsidiary, Spang, Chalfant & Co., Inc., a Pennsylvania corporation, herein called "Spang".

Stanford owned as an investment 1300 shares of preferred stock in the Delaware corporation, on which large amounts of dividends were in arrears. The Delaware corporation and Spang consolidated under Delaware and Pennsylvania law,* and as a result Stanford's stock and the arrears of dividends thereon were automatically converted into certain stocks of defendant.

Stanford sued defendant for damages caused by the consolidation, asserting three independent causes of action,

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*The Delaware law, here involved, consists of Secs. 59-61 of the General Corporation Law of Delaware. The text of these sections is set forth in the Appendix to the attached Brief, pages i to viii incl.

each of which alone justified the judgment sought. Two were for frauds and the third for violation of the Federal Securities Act of 1933. The District Court found the facts for plaintiff on all the issues (R. 225-87) and entered judgment for $260,840.38* and costs (R. 313-15).

The trial court found two intentional frauds, which we call the primary fraud and the secondary fraud. The primary fraud was the adoption of an unfair plan of consolidation which deprived Stanford and other preferred stockholders of more than $6,000,000 in values—between one-third and one-quarter of the total values of their old preferred stock and accrued dividends thereon—transferring such values to the common stock. The findings were not only that the plan had this unfair result (R. 249-51 and 274), but that the result was deliberately designed by the directors of the Delaware corporation for the wrongful purpose of benefiting their own common stock (R. 235-9, 246-7, 275, 278).

The secondary fraud upon Stanford consisted of the concealment by the directors of the right of every stockholder of the Delaware corporation to obtain the fair value of his stock pursuant to an appraisal under the Delaware statute† and the further concealment of the fact that if a stockholder did nothing about his stock he could not retain that stock under the plan, but would find the stock automatically converted into shares of the consoli-

*This amount was based on plaintiff's tender of its stock to defendant and the deposit of such stock with the Court pursuant to such tender (R. 303-13).

†A right which we call herein the "Delaware appraisal right" and which is granted by Sec. 61 of the Delaware General Corporation Law, Appendix to attached Brief, pages vi-viii.

dated corporation (defendant).* The District Court found not only that the Delaware appraisal right and automatic conversion were concealed by the letter which the directors of the Delaware corporation sent to Stanford and other stockholders (R. 259-62), but that these concealments were intentional and deliberate on the part of the directors, being for the purpose of avoiding the payment of cash to stockholders, who might exercise the Delaware appraisal right if they knew the facts (R. 259, 263-4, 281). The trial court further found that Stanford relied on the letter from the directors as a summary of the consolidation plan and was thereby misled into doing nothing until too late, thus losing its Delaware appraisal right and losing also its old shares by reason of their automatic conversion into stock of defendant (R. 259-65).

On the Securities Act cause of action, the District Court found that the letter offering defendant's shares to plaintiff in exchange for the old stock was sent through the mails but without registration of the new stock under the Securities Act (R. 279, pars. 46-7).

The Circuit Court of Appeals reversed the District Court (R. 3000-1) without expressly setting aside any finding or considering the sufficiency of the evidence to support the findings or the sufficiency of the findings to support the judgment.† Primarily the reversal is based

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*A result which we call herein "automatic conversion" and which is provided for in Sec. 59 of the Delaware General Corporation Law, Appendix to attached Brief, p. i.

†See the appellate court's opinion (R. 2986-3000), hereinafter called the "Reversing Opinion". It is reported in 134 F.(2d) at 689-694 incl.; but references herein are to the copy in the Record.

upon the holding that Stanford's representatives were negligent in failing to study the detailed "Agreement and Joint Plan of Consolidation",* which accompanied the letter from the directors. According to the Reversing Opinion, a study of the plan and agreement would have led to the discovery by Stanford of the Delaware appraisal right and automatic conversion (R. 2996-8).

This holding of negligence is made despite the following findings by the District Court:

1. The finding that the letter on which Stanford relied and which concealed the Delaware appraisal right and automatic conversion, appeared to be, and was intended by the directors to appear as, a summary of the plan and agreement (R. 259);† so that the Reversing Opinion either ignores this fact or else holds that it is negligence for a stockholder to rely on a letter sent to him by the directors of his corporation, which summarizes an important corporate plan.
2. The findings by the District Court which demonstrate, as above explained, that each of the frauds was wilful and deliberate; so that the Reversing Opinion either ignores these facts or else holds that contributory negligence is a defense to a claim for intentional fraud perpetrated by fiduciaries (directors) against their beneficiary (a stockholder).
3. The fact which is implicit in the findings, namely, that the asserted negligence—plaintiff's failure to investigate further—did not in any way contribute to the primary fraud—the adoption of the unfair plan. The plan, of course, was the work of the directors alone. All that plaintiff's failure to investigate did

*Herein called the "plan and agreement".

†This finding is based on an admission by defendant in the pleadings (R. 35, 162).

with respect to the unfair plan was to cause plaintiff to lose one available remedy for this fraud, namely, the Delaware appraisal right. By holding that plaintiff's negligence, resulting in loss of this one remedy, also bars another remedy, in this case plaintiff's right to recover in an action for damages for fraud, the Reversing Opinion necessarily decides that the Delaware appraisal right is an exclusive remedy.

The Reversing Opinion also mentions "estoppel" and "laches", at least as makeweight grounds for reversal (R. 2999). In so doing it apparently relies in part on the theory that after the consolidation Stanford accepted checks for dividends on the stock of the consolidated corporation (defendant). See the statement to this effect in the opinion (R. 2989). However, the District Court found upon uncontradicted evidence that the dividend checks were cashed, not by Stanford itself but by its bank, and without any knowledge that they related to stock of the consolidated corporation; also that as soon as Stanford discovered that they were dividends on the new stock it immediately tendered them with interest to defendant (R. 282).

The Reversing Opinion similarly ignores other important findings in its apparent holding of laches and estoppel. (Compare the opinion at R. 2999 with the findings at R. 264 and 282-5). The most important example of this should be mentioned here in view of the fact that the decision on this subject seems to be based largely on mere delay. Obviously mere delay for not over seven months*

*The Delaware corporation stockholders' meeting, which voted the plan, was held October 11, 1937 (R. 279-80). This suit was filed May 11, 1938 (R. 146) and summons was served on May 12, 1938 (R. 13).

could not result in laches or estoppel unless the delay caused prejudice. And yet the Reversing Opinion completely ignores the District Court finding which shows that defendant was not prejudiced by plaintiff's delay, namely, that if plaintiff had acted at the earliest possible time neither the predecessor companies nor the directors would have followed any other course than that which they did follow, except that they might have long since paid to plaintiff the value of its shares (R. 283).†

With respect to the Securities Act, the Reversing Opinion simply holds that an exchange of stocks in a consolidation does not involve a "sale" and therefore the Act is not applicable (R. 2999). No reason is given except a reference to the views of the Securities and Exchange Commission as expressed in an *amicus curiae* brief.‡

For reasons which will appear hereinafter, plaintiff filed a petition for a rehearing by all seven Judges of the Circuit Court of Appeals sitting in bank. This petition, which is described in the Record as one "for a rehearing * * * and for a hearing en banc" (R. 3001), was considered solely by the same three Judges who rendered the Reversing Opinion, being denied by them without the participation of any other Judge (R. 3001).

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†This finding is unassailable by defendant because based upon the express testimony of its President, who was also President of the Delaware corporation (R. 1084-93).

‡The Commission's brief was confined to legal questions under the Securities Act and was careful to take no position on the fraud points.

STATEMENT OF BASIS OF JURISDICTION

1. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, U.S.C.A., Title 28, Section 347(a). The jurisdiction of the District Court was invoked under Section 24(1) of the Judicial Code, U.S.C.A., Title 28, Section 41(1) pursuant to appropriate proceedings for removal from the state court because of diversity of citizenship under Sections 28 and 29 of the Judicial Code, U.S.C.A., Title 28, Sections 71 and 72. (See R. 1-17.)

2. The judgment of the Circuit Court of Appeals was entered April 1, 1943 (R. 3000-1). Petition for rehearing, filed April 30, 1943, was denied May 22, 1943 (R. 3001).

QUESTIONS PRESENTED
and
REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

This petition presents at least five important questions, each of which involves one or more special and important reasons for allowance of the writ within the meaning of subdivision 5(b) of Rule 38 of the Supreme Court Rules. Because of this complexity, we propose to state each question and then follow with the reasons for allowance of the writ as to that question, rather than to first list the questions and then give the reasons separately.

Question 1: If plaintiff was negligent in relying upon a summary of a consolidation plan sent by the directors of plaintiff's corporation to plaintiff as a stockholder, instead of studying the detailed plan itself, is such negligence a defense to causes of action for deliberate and wilful frauds

perpetrated by the directors—fiduciaries—against plaintiff —their beneficiary?

Reasons for Writ on Question 1: The Circuit Court of Appeals has squarely held in this case that contributory negligence is a complete defense to a claim for intentional fraud perpetrated by a fiduciary against his beneficiary. This is not only a decision on an important and basic question of law, but it is directly in conflict with the local law of California, where the fraud was perpetrated, as established by applicable decisions of the California Supreme Court,* and indeed, it is in conflict with local law as established everywhere by applicable decisions, including those of the United States Supreme Court and other Circuit Courts of Appeals.†

Question 2: If plaintiff's failure to investigate a detailed corporate plan more fully is negligence, is it *contributory* negligence constituting a good defense to plaintiff's cause of action based on the adoption of an unfair plan, when this negligence did not contribute in any way to the fraud consisting of the adoption of the unfair plan, but merely resulted in the loss by plaintiff of one alternative remedy for such fraud, namely, the statutory appraisal right to obtain fair value for its shares?

**Seeger v. Odell* (1941) 18 Cal.(2d) 409, 414-5; 115 Pac.(2d) 977, 980-81; *Rutherford v. Rideout Bank* (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2; and other cases cited in attached Brief, pages 21-2.

†*Equitable Life Insurance Co. v. Halsey etc. Co.* (1941) 312 U.S. 410; *W. P. Walker & Co. v. Walbridge* (C.C.A. 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605); *Falter v. United States* (C.C.A. 2, 1928) 23 Fed.(2d) 420, 424 (Cert. den. 277 U.S. 590); and other cases cited in attached Brief, pages 21-2.

Reasons for Writ on Question 2: By holding that plaintiff's negligence, resulting in loss of the statutory appraisal remedy, also bars one of plaintiff's alternative remedies, namely, an action for damages for fraud, the Circuit Court of Appeals necessarily decides that the Delaware appraisal statute provides an exclusive remedy. This decision squarely conflicts with other applicable cases, not only decisions of state courts, including the Delaware Court of Chancery,* but also one by another Circuit Court of Appeals in which certiorari was denied,† and even a dictum of another group of Judges of the Ninth Circuit.‡ All these cases hold that where an appraisal statute does not expressly provide that it is exclusive (as does the California statute), it is not to be construed as exclusive, and other remedies are permitted. On this important question of law there is thus both conflict with local decisions and conflict with another circuit, requiring certiorari.

Question 3: Although the issuance of stock by a corporation in exchange for other stock is ordinarily a "sale" within the meaning of the Federal Securities Act of 1933, is such issuance of stock prevented from being a "sale" where it occurs in a consolidation or other corporate transaction in which the exchange is brought about under state law by vote of the directors and stockholders acting in their corporate capacities?

**Cole v. National Cash Credit Ass'n.* (Del., 1931) 18 Del. Ch. 47, 156 Atl. 183, and see other state court cases cited in attached Brief, page 28.

†*May v. Midwest Refining Co.* (C.C.A. 1, 1941) 121 Fed.(2d) 431, 438 (Cert. den. 314 U.S. 668).

‡*Beechwood Securities Corp., Inc. v. Associated Oil Co.* (C.C.A. 9, 1939) 104 Fed.(2d) 537, at page 540, last paragraph and footnote 2.

Reasons for Writ on Question 3: The registration requirements of the Federal Securities Act are applicable to a "sale" of stock or an offering of such stock for "sale".* The Securities and Exchange Commission, through its counsel, has taken the position that while ordinarily an exchange of stock involves a sale, this is not true where the exchange takes place under a statutory consolidation, merger or other reorganization pursuant to state law, in which the plan is adopted by action of the directors and stockholders, each acting as a body by a specified majority vote. The Circuit Court of Appeals here follows this view of counsel for the Securities and Exchange Commission, but without discussion of the reasons, merely referring to the *amicus curiae* brief of the Commission, which is of course not generally available to persons interested in the question (R. 2999-3000). The specific holding here is that an offer of an exchange in a consolidation is not an offering for "sale" which requires registration.

The question whether registration is required in case of the issuance of securities in a consolidation, merger or reorganization plan is of great importance throughout the country and raises a question of Federal law which has not been, but should be, settled by the Supreme Court, particularly in view of the manner in which the Circuit Court of Appeals has disposed of the question, i.e., without indicating its own reasoning.

So far as we know, this is the first reported case in which this problem has been raised. We have received numerous inquiries as to the status of the

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*The applicable provisions of the Securities Act are set forth in the Appendix to the attached Brief, pages viii-ix.

case from counsel in various parts of the country. These indicate how important it is to have the law established by the Supreme Court, so that attorneys may advise their clients as to whether or not to register securities issued in the many corporate reorganizations continually taking place.

Question 4: Is it correct practice for the Circuit Court of Appeals to set aside important findings of the District Court without consideration of the supporting evidence or other cause?

Reasons for Writ on Question 4: Rule 52(a) of the Federal Rules of Civil Procedure forbids any appellate court from setting aside a finding of fact unless clearly erroneous and the same rule affirmatively requires that due regard shall be given to the opportunity of the trial court to judge of the credibility of the witness. Here the Circuit Court of Appeals violates this rule by setting aside findings through ignoring them, without making any attempt to determine whether or not they are supported by the evidence. As we have pointed out above, these findings, so ignored, include some of the most important findings which, if given weight, would have necessarily altered the decision of the appellate court. One of these was the finding that the letter on which plaintiff relied was intended as, and appeared to be, a summary of the plan and agreement (above, p. 5). This finding demonstrated that plaintiff was not negligent in relying on the letter. Other important findings which were similarly ignored include the findings as to the wilful and deliberate character of the frauds of the directors (above, pp. 3-5), which should have prevented the appellate court from sus-

taining negligence as a defense, and the numerous findings which negatived the existence of laches or estoppel (above, pp. 6-7).

We submit that the Circuit Court of Appeals for the Ninth Circuit has so far departed from the accepted and usual course of judicial proceedings in its treatment of findings of fact that the Supreme Court's power of supervision should be exercised to require the correct practice.

Question 5: When a Circuit Court of Appeals decision conflicts with a prior opinion of a different group of Judges of the same Court and also conflicts with applicable decisions as to local law and departs from accepted appellate procedure, and when the losing party petitions for a rehearing by the entire Court *in bank* in an effort to have these errors corrected, is it proper for the Circuit Court of Appeals to have this petition passed upon solely by the three Judges who participated in the original erroneous opinion (and who are a minority of the Court) without participation by any other Judge?

Reasons for Writ on Question 5: In this case plaintiffs deemed that they were entitled to a rehearing by the entire Circuit Court of Appeals in bank, because (if for no other reason) the Reversing Opinion conflicted with a prior opinion of a different group of Judges of the same Court, as explained under Question 2 above. They also felt that the conflicts with other decisions on local law, including opinions of other Circuit Courts of Appeals, as explained under Questions 1 and 2 above, and the departure from correct appellate procedure, as explained under Question 4 above, were such as to

justify a rehearing in bank. They filed a petition for such a rehearing, which was treated by the Circuit Court of Appeals as a combined petition for rehearing and for a *hearing in bank* (R. 3001). However, as the Record shows, this petition was passed upon solely by the same three Judges who rendered the opinion in the first instance, without participation by any one of the other four Judges of the seven-judge Court (R. 3001).*

This may be correct practice, but, if so, the result is that as a practical matter a petition for rehearing by the Circuit Court of Appeals in bank is meaningless, since the Judges who first heard the case would not normally grant a petition to have their own decision reviewed by the entire Court unless they believed such decision doubtful, in which case they would be equally willing to grant an ordinary petition for rehearing, so that a rehearing in bank would be unnecessary. And yet the Supreme Court held in

Textile Mills Securities Corp. v. Commissioner
(1941) 314 U.S. 326

that a Circuit Court of Appeals has the right to hear an appeal in bank. In that case it affirmed a decision of the Circuit Court of Appeals for the Third Circuit in which the opinion said that where a difference of opinion between different groups of Judges has arisen, "it is advisable that the whole court have the opportunity, if it thinks it necessary, to hear and decide the question" (117 Fed.(2d) 62, 71). How can the

*We understand that pursuant to established practice in the Ninth Circuit the petition was not examined on its merits by any of such other four Judges, but that after a cursory examination as to its character by the presiding Judge, it was referred solely to the three Judges who had already heard the appeal.

other Judges determine whether they are so minded, if the practice of the Court prevents them from reading the petition which puts the question?

We do not know what should be established as correct practice for rehearings in bank, but the problems involved raise important questions of Federal law and procedure as to which there is no existing authority, so far as we know, and which therefore should be passed upon by the Supreme Court. We venture to suggest that, at the very least, the Supreme Court might indicate whether or not the respective Circuit Courts of Appeals have full authority to decide such questions, as by adopting their own rules concerning rehearings *in bank*. Thus certiorari is called for on this point alone.

WHEREFORE, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the Record and of all proceedings in the case numbered and entitled on its docket No. 10,270, *The National Supply Company, a corporation, Appellant, vs. Leland Stanford Junior University and Elmer H. Shine, Appellees,* and that the judgment of said Circuit Court of Appeals be reversed, and that the judgment of the United States District Court for the Northern District of California, Southern Division, in favor of petitioner Leland Stanford Junior University against defendant in the sum of $260,840.38, together with costs of $1,670.66, which judgment was reversed by said Circuit

Court of Appeals, be affirmed by this Court, and that your petitioners have such other and further relief in the premises as to this Court may seem proper.

JOHN T. PIGOTT,
Attorney for Petitioners.

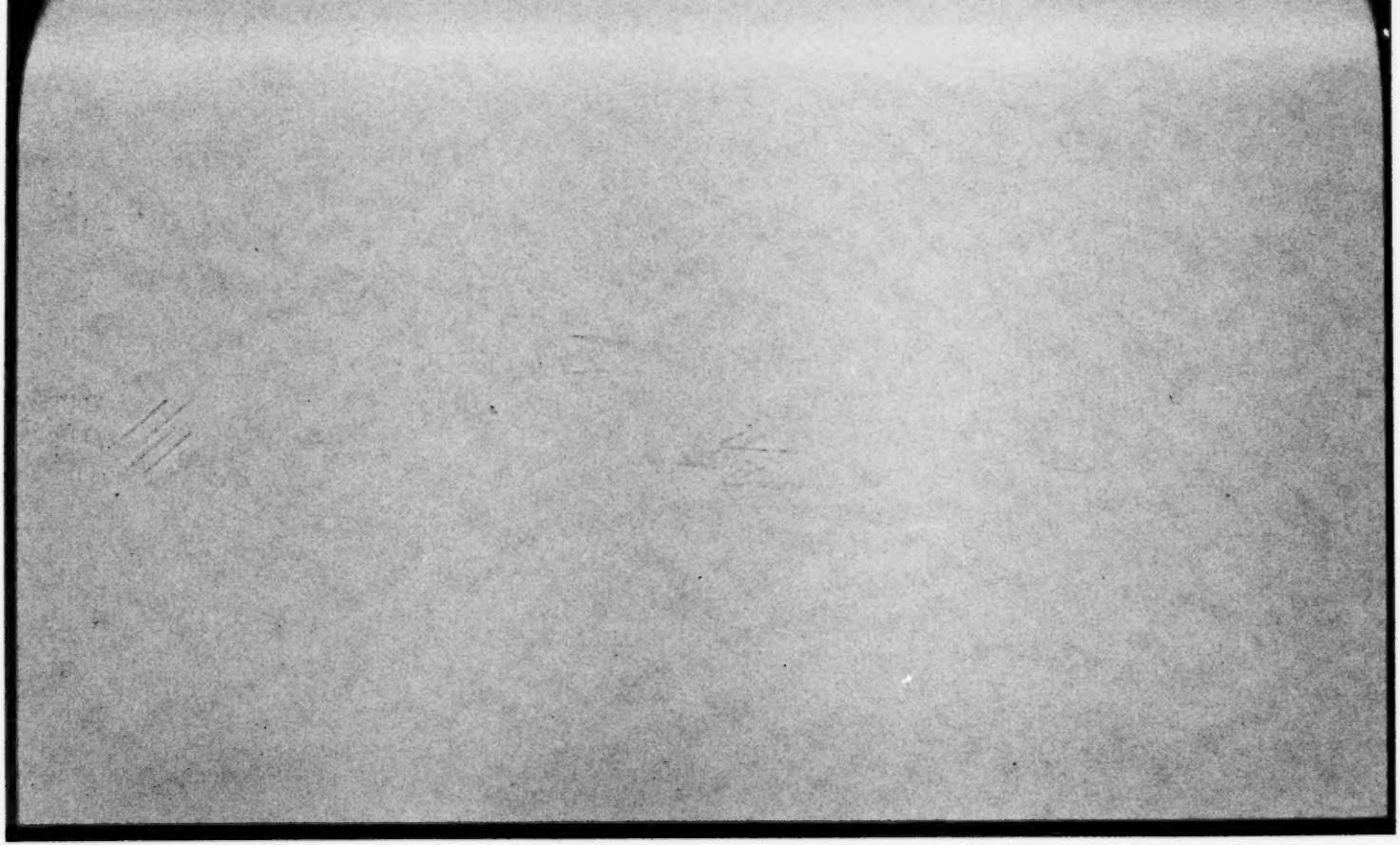
HENRY D. COSTIGAN
MORRIS M. DOYLE
McCUTCHEN, THOMAS, MATTHEW, GRIFFITHS & GREENE,
of Counsel

Dated: San Francisco, California, August 2, 1943.

CERTIFICATE OF COUNSEL

The undersigned counsel for petitioners in the above and foregoing Petition for Writ of Certiorari hereby certifies that in his judgment said Petition is well founded and is not interposed for delay.

JOHN T. PIGOTT



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